SolarCity Corp (SCTY) Earnings Report: Q3 2015 Conference Call Transcript

The following SolarCity Corp conference call took place on October 29, 2015, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Aaron Chew; SolarCity Corporation ; IR
- Lyndon Rive; SolarCity Corporation ; CEO
- Brad Buss; SolarCity Corporation ; CFO
- Peter Rive; SolarCity Corporation ; CTO
- Tanguy Serra; SolarCity Corporation ; COO

Other Participants

- Patrick Jobin; Credit Suisse ; Analyst
- Noah Kaye; Oppenheimer & Company ; Analyst
- Philip Shen; Roth Capital Partners ; Analyst
- Brian Lee; Goldman Sachs ; Analyst
- Tyler Frank; Robert W. Baird & Company ; Analyst
- Julien Dumoulin Smith; UBS ; Analyst
- Krish Sankar; BofA Merrill Lynch ; Analyst
- Stephen Byrd; Morgan Stanley ; Analyst
- Gordon Johnson; Axiom Capital Management ; Analyst
- Jerimiah Booream; Deutsche Bank ; Analyst
- Michael Morosi; Avondale Partners ; Analyst
- Edwin Mok; Needham & Company ; Analyst
- Pavel Molchanov; Raymond James ; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the SolarCity third-quarters 2015 earnings call.

(Operator Instructions)

As a reminder, this conference is being recorded it.

It's now my pleasure to introduce your host Aaron Chew. Thank you Mr. Chew you may begin.

Aaron Chew (IR):

Thank you. Good afternoon to everyone joining us today for SolarCity's third-quarter 2015 earnings conference call. Leading the presentation today will be a discussion from our Chief Executive Officer Lyndon Rive; our Chief Technology Officer, Peter Rive; our Chief Operating Officer, Tanguy Serra; as well as our Chief Financial Officer, Brad Buss, after which point in time, we'll open up the call to questions.

As a reminder, today's discussion will contain forward-looking statements that involve our views as of today based on information currently available to us. Forward-looking statement should not be considered a guarantee of future performance or results, and reflect information that may change over time.

Please refer to SolarCity's quarterly shareholder letter issued today, as well as the slides accompanying this presentation, and our periodic reports filed with the Securities and Exchange Commission for a discussion of our forward-looking statements and the factors and risks that could cause our results to differ from these forward-looking statements. We do not undertake any obligation to publicly update or revise any forward-looking statement.

In addition, during the course of this call, we'll use a number of specially defined terms related our business metrics and financial results, including non-GAAP financial metrics. We refer to all the definitions of these terms and the required reconciliation between GAAP and non-GAAP financial metrics included in the shareholder letter issued today, as well as the slides accompanying this presentation, which are available on our Investor Relations website, investors.SolarCity.com With that finally behind us, I would like to introduce SolarCity's Chief Executive Officer, Mr. Lyndon Rive.

Lyndon Rive (CEO):

Thanks, Aaron. Thanks, everybody for joining the call. We're going to try a different format in this call. Instead of going through the slides, you have the access to the slides, we're going to spend most of the time addressing questions. Before we get to the questions, I want to go over a quick Company update, Brad will just discuss some of the updates on finance, and Peter will get into a discussion on net metering.

Quick recap for Q3. We installed 256 megawatts, which is a new record, but slightly lower than our 260 megawatt forecast. I'm disappointed in this number, but just to put it in perspective, at our current rate of installation, we install roughly 2.5 to 3 megawatts a day, so we missed it by 1.5 days or so.

All the fundamentals of the business is looking good. Cost reduction is coming down nicely. Demand for the product is strong, and the economic value we created this quarter was $239 million. That's quite an amazing number. Looking at the last nine years, the strategy of the Company has all been about growth.

The reason why we have focused on growth is we need to achieve scale. The only way you can reduce cost is with scale. The last nine years, we have been growing roughly 80% to 90%, but there is the downside of growing at 80% or 90% is you have to make investments into the infrastructure today, which you only recognize the benefit of that investment two to three quarters later, so that there is a cost to that scale.

Now that we've achieved scale, we as an executive team and a Board have decided to focus on cost reduction and being cash-flow positive by the end of 2016. With this new focus, we are going to reduce our growth rate to roughly 40% in 2016. For a company our size, 40% is still a very big growth rate, but this will enable us to focus on profitable installations, the more profitable installations, as well as reducing our customer acquisition cost.

If you look at our Q3 install costs, we've almost achieved a 2017 goal of $1.90 a watt. Now that we investing less into growth, we're going to be updating our 2017 cost goals. By the next earnings call, expect updated cost targets from 2017 and expect a meaningful reduction to our $2.50 a watt by 2017.

One thing I want to make clear, that this change in focus is not a lack of demand. We expect in Q4 bookings to be greater than Q3 bookings. Normally, Q4 is lower than Q3 because of the seasonality. We have less selling days. But the demand is strong. In 2016, we expect the demand to be very strong.

When you have an expiring tax credit, or tax credit gone from 30% down to 10%, the customer is going to rush to get in to not miss the opportunity, so we expect the demand to be strong in 2016. We are actually going to be increasing our pricing in Q1 next year. It will be a small increase; depending on the state, we'll increase roughly $0.025, to $0.01 cent a kilowatt hour in our leases [and TPAs].

Essentially, maxes the escalation of the utility rates. Overall, I'm very excited about the business, and the strategy change. We're now at this inflection point where we're going to become cash flow positive by the end of 2016, and have a cost structure where the business can maintain cash flow positive in 2017 with a 10% accuracy. I'm going to pass it on to Brad.

Brad Buss (CFO):

Thanks, Lyndon. Just a quick couple comments on Q3. Overall, we had a very successful quarter with great results and records Lyndon touched on. I just want to emphasize a couple things. The recommend value creation of $239 million we achieved, that was up 22% sequentially, with solid IRRs of 12%, and that's with fully loaded costs. If you look at it on a project basis like many competitors who do, it's much closer to 16%.

Also at the end of Q3, had record gross retained value of $4.4 billion and net retained value of $3.3 billion, which is approximately $33 per outstanding share. As far as our PowerCo available cash, which we introduced in Q2, I just want to explain a couple of timing differences that we tend to see and that you will continue to see going forward.

If you look at just the Q3 number, our PowerCo revenue was $95 million, and that was due to increase the assets and service, as well as strong system performance because Q3 tends to be our extremely sunny period. The final [PAC for adjusting] in Q3 was $19 million. Again, that was due mainly from the timing of certain payments for debt and interest that typically happen at a higher level in Q1 and Q3 and the same thing for higher distributions to our tax equity partners.

If you now look at things on a trailing 12-month period, which we review on the best measure to see how PAC is moving on an annual basis, the PowerCo revenue increased 17% sequentially, and the net PAC from operations and prior to any distributions to our tax equity partners and/or debt service included 7% sequentially. The final PAC was $112 million, and it down 2%, but again that was really due to the timing of the payments, where really it's a debt tax equity and interest as I mentioned, and you'll continue to see those fluctuations in Q1 and Q3.

I want to just touch briefly on our financing strategy. There's always been a lot of turmoil on the solar industry as of late and a lot of questions related to financing coming up. We went to great lengths in our shareholders letter, as well as the earnings deck, to explain that our financing structure for the our main products, which are leases, PPA, and MyPower loans are very different from some of our peers and obviously very different than some of the current challenges that certain yield costs are facing.

The bottom line is that our solar asset financing strategy is very sound and it focused on tax equity, aggregation facilities, and ABS. We have ample room on our main tax equity and ag facilities, which really provide the bulk of our year one cash. In addition, as most of you know, we completed our financing, with the takeout via the ABS market in August, and I expect to have a regular cadence from here on.

All of our guidance is detailed in the earnings deck for Q4, as well as 2016. But just to ensure that we're all on the same page, I want to let you know that the cash flow break-even that Lyndon talked about, and how we're going to define that. All of that will come right off of our quarterly financials.

The formula that we're using is the net increase in cash and investments, which obviously includes securities, et cetera, less net cash provided by equity issuances that comes off the cash flow is going to be greater than or equal to zero. So I'll just wrap up there and I'll now turn it over to Pete to cover one of our favorite subjects.

Peter Rive (CTO):

And by favorite subjects, he means net metering. Utility opposition to rooftop solar is getting a lot of airplay, so I would like to give you our take on the situation. Despite utility efforts, regulators are rejecting proposals to unfairly penalize solar customers as evidenced by recently failed attempts in Colorado, New Mexico, and Kansas.

Additionally, net metering caps were recently extended in New Jersey, New York, and the Nevada PUC extended its program through year-end while it evaluates the benefits of rooftop solar. It's important to note that a previous study conducted in Nevada showed the benefits outweigh the revenue shift.

In Arizona, this week we achieved another victory against utilities attempting to abuse their monopoly positions. In our case against SRP, a judge ruled that the utility must answer in court for the unfair and anti-competitive penalties it is imposing on solar customers.

In Hawaii, which is a very special case, with double the market penetration and extremely high electricity prices, the PUC issued a new solar tariff, which had some good and some bad components to it. Bad was the lack of due process and the abrupt way in which it would take effect.

But good in that it provides [x leaded] and mandatory interconnection for solar systems that do not backfeed onto the grid, which is whey they're referring to as a self-supply tariff. We're working on a self-supply solution that could restore Hawaii to a high-growth market for us at some point.

Then moving to California, the California Public Utilities Commission is expected to release their new net metering tariffs in the coming months, and this is an important one for us. In general, we're hopeful of a good outcome for two reasons. First, we believe the benefits of rooftop solar are greater than the revenue shift, and by benefits I mean the ability to avoid distribution and transmission expenses and so on.

And then secondly, a decision that ensures continued growth of rooftop solar is required by law. I'm going to quote directly from Assembly Bill 327, and this is in reference to [an MTO doe]. This commission shall do all of the following, and then first point is, ensure that the standard contract or tariff made available to eligible customer generators ensures that customer-sited renewable distributed generation continues to grow sustainably. I want to reemphasize that it is required by law that, that happens.

So then, if we think about is, it's important that the [discussions] are going to go away. Forever that the utilities will try to impose penalties on rooftop solar. Over time there's going to be give and takes on both sides, but we're optimistic that in the face of climate change and the benefits, as well as popularity of solar power, that state agencies will close policies that slow down solar adoption. And with that, I would like to move to the question-and-answers part of the call.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Thank you. Our first question comes from Patrick Jobin of Credit Suisse. Please go ahead.

Patrick Jobin (Analyst - Credit Suisse):

Hi, thanks for taking the question. First question on 2016 guidance, maybe some of the thought process that you guys went through to form the 40% growth, from our perspective, a meaningful deceleration.

Was that guidance impacted by any market demand constraints, policy uncertainty, conservatism building out the Organizational capacity to avoid any underutilized capacity in 2017, capital capacity constraints, Organizational constraints or any competitive pressures? I just want to better understand some of the motivating factors? Thanks.

Lyndon Rive (CEO):

Yes, really good question. There's a couple of areas. First, if you look at our current acquisition cost, it's around $0.64 a watt. Growing at 80% to 90%, that last push for those last customers, they're really expensive, so we want to reduce our acquisition costs, so by slowing it down, then we can reduce our acquisition costings.

The other is the best time to plan for a 10% ITC and optimize the Company for a 10% ITC is not when you're in the 10% ITC world, it's when you're in the 30% ITC world. That's when you want to make the change.

If we make this focus in 2017, it's going to be a lot harder to do it then than it is to do it now. That's another reason why we decided to do it earlier. We want to show the market that we can have an extremely low cost and also be cash flow positive and maintain cash flow positive in 2017.

The other point I want to emphasize is when you're growing at 80%, beyond the high acquisition cost, the only way you can maintain an 80% growth rate, you have to make big, big investments, but you're only going to see the results of those investments two to three quarters later.

So doing that when you know that you have to get to a cost structure where we want to strive to be cash flow positive in 2017, are all the reasons why we decided to reduce the growth rate. And I do want to follow-up with find companies that [are at the point of] infrastructure that have 14,000 employees that are growing at 40%.

Peter Rive (CTO):

And that's mainly what's the point, in terms of revenue growth, it's going to be in excess of 70%.

Lyndon Rive (CEO):

Exactly. So it is not our standard 80% growth, but not that 40% is a low growth number, just wanted to emphasize that.

Patrick Jobin (Analyst - Credit Suisse):

Got it. Then so just to follow up, when you think about sales costs, how wide was that differential between that first 40% for growth and that -- the last few customers to get you to that 80%, 90% growth level. How varying is that incremental sales-related cost or how wide is that range?

Tanguy Serra (COO):

Hey, Patrick, it's Tanguy, I'll take that. That range is actually quite wide. If you think about it our best form of acquisition is referrals by definition. Referrals, those are our cheapest customers to acquire and some of our -- because we're the most grateful for.

Then you walk [the cost slack up]. Direct energy is a phenomenal cost acquisition channel. Then as you continue walking your [slack] up, when you have to pay for leads and then closing costs, the costs are higher. So the spread is -- don't want to give the spreads number too widely out because then we disclose our cost structure by channel, but it's a material spread if you're paying for a lead or if you're not paying for a lead.

Patrick Jobin (Analyst - Credit Suisse):

Thank you.

Operator:

The next question is from Noah Kaye of Oppenheimer & Company. Please go ahead.

Noah Kaye (Analyst - Oppenheimer & Company):

Thank you. First maybe want to start off with the policy front. Can you give us an idea of what you're actually seeming for NEM2.0, how soon you expect the decision to be, and of what your baseline assumptions are, and maybe positive, negative rise around that, and how that might influence your outlook for next year?

Peter Rive (CTO):

We're expecting something out of PUC in the next two months or so. I got to say that it's not easy for us to build in specific assumptions into planning for California. Again, what gives us great comfort is the fact that AB 327 says, by law that the tariff that the PC comes up with must ensure that rooftop solar continues to grow sustainably. It would just be speculating at this point, and I'd rather not do that.

Noah Kaye (Analyst - Oppenheimer & Company):

Okay. That's only fair. If we can turn to the financing, so successfully closing the ABS, I believe this was the first time it was a new financing structure for you guys that underpinned those leases. Can you talk a little bit about -- expand a little bit more on the cadence of future ABSs, and in particular, where you expect loan-to-value to trend?

Brad Buss (CFO):

Thank you. You hit a key point. All of our lease structures for our leases and PPAs are now rated, which is great, and they all have an investment-grade rating. But the next thing that would end up coming up actually will be the MyPower loans, and then really all of our products are totally rated. So from a cadence standpoint, remember, since we have tax equity funds underlying these, we basically fill a fund up.

Once a fund is filled up, and we have some fairly large funds that tend to have been a year in length, so that once they're done, we'll put them right out into the ABS markets right away, so hence we did have a little bit of a lull, as you noticed in this year, but you'll see the cadence. As soon as these funds are done, they'll be coming out the door.

You'll see much more frequent issuances going forward. And as far as the advance and all the rates, they really just depend at the time, the market structure, but I would expect the advanced rates for leases and PPAs to be fairly stable to what we have seen, and probably be as good or better when we get into the MyPower situation since it's a very different product with no ITC in it.

Noah Kaye (Analyst - Oppenheimer & Company):

Right. Okay. Thank you, I'll turn it back over to you.

Lyndon Rive (CEO):

Yes, thank you.

Operator:

The next question comes from Phillip Shen of Roth. Please go ahead.

Philip Shen (Analyst - Roth Capital Partners):

Hey, guys, thanks for taking my questions. In the last quarter, you guys talked about normalized PAC, or power flow cash flow, of being closer to $166 million. With the variability that we saw in Q3, what do you think the normalized PAC ought to be on a go forward basis?

Brad Buss (CFO):

Again, the normalized, that reflected the tax equity distributions added back, just so we're all on the same page. As I went through here, and in the letter, and hopefully people understand the that variability between Q1 and Q3, there's very different timing for all of those payments.

We show you by quarter so you can see that. As we add more debt, that obviously goes into the number and your payments there, but the revenue will move accordingly. We're not in a position to give you a guidance on it at this point, but I would say, year-on-year, it's going to continue to grow substantially.

Philip Shen (Analyst - Roth Capital Partners):

Great, thanks, Brad. You guys did a great job on expanding commercial in the quarter. Can you give us some more color on this commercial strength. Is it the small commercial segment that's driving growth, as you guys referred to in the last quarter and what kind of mix of commercial could we see in Q4 and as we go through 2016?

Lyndon Rive (CEO):

Yes, appreciate the question on commercial. It's a good topic for us. The commercial, what we have done, if you remember, we have insourced the construction costs of commercial using our own crews. That's been massively successful beyond our expectations, candidly.

So what we have done is we've dramatically reduced the cost structure of commercial in a place where I'm actually really excited about our commercial costs on a go-forward basis. What that has done is that has enabled us to build ground mounts, large ground mounts, as well as roof tops at a low cost, which by definition, we can bid reasonably attractive, very attractive, higher prices to our end customers.

That feels really, really good. The mix is, it's mostly, there's no average by definition, but there's, call it, 1 megawatt ground mount, it's pretty standard, 500-kilowatt roof, it's pretty standards, and then some smaller carports, in particular, for schools in California.

Philip Shen (Analyst - Roth Capital Partners):

The mix I was referring to is in so far as you can share, of the guidance for Q4, 290 megawatts, how much of that could be commercial?

Lyndon Rive (CEO):

I'm looking at Brad, making sure I'm answer your question (laughter). He's saying yes. The mix will be somewhere between 70 and 90 megawatts of commercial in Q4 of installs.

Philip Shen (Analyst - Roth Capital Partners):

Great. Very helpful.

Operator:

The next question is from Brian Lee of Goldman Sachs , please go ahead.

Brian Lee (Analyst - Goldman Sachs):

Hey, guys, thanks for taking the questions. I had several, actually. Maybe a simple one. How should we be thinking about 2017 in the context of this new pivot and strategy? What does it mean for targeting growth beyond the ITC?

Lyndon Rive (CEO):

I still expect to see a growth in 2017 and it will be a cash flow positive. That's the whole pivot on it. This is the reason why we are pivoting right now, is so that we have a cost structure, that we have a growth year in 2017.

Brian Lee (Analyst - Goldman Sachs):

Okay. Fair enough. Since -- that's a good segue into the next set of questions I had. On that positive cash flow metric, Lyndon, if I use your install targets, it seems you would have to be down to $2.30 per watt of all-in cost by the end of 2016 to get to break-even based on the cumulative capacity that you're targeting here, so wondering if that's the right read here, first of all, and then I have to follow up on that?

Lyndon Rive (CEO):

Brad, I want to say, your math, you know your [motor fuel] well, but I don't want to give guidance just yet on the costs. But you're good at math (laughter) so I'm not giving guidance on that. But you're good at math.

Brian Lee (Analyst - Goldman Sachs):

Okay. Thank you for the compliment. Maybe I'll hop back to volumes then. On the 2015 outlook, in the shareholder letter, you're mentioning some uncertainty around commercial installs in December. So are you actually expecting things to slip into 2016, because I would have figured if all goes according to plan, your original outlook, even it's the low end, would have remained intact. Is there anything that might be falling out here or is growth simply just slower than you might have thought?

Lyndon Rive (CEO):

We just don't want to push too hard on the growth, as once again, that's a higher cost. So maintaining this 80% growth, in terms of installation, had extra costs. We just want to reduce that, and then combined with the [ton] you just mentioned on the megawatt strings, you're looking at 20-megawatt strings there on the commercial.

Brad Buss (CFO):

Yes, very late in the year, with weather, holidays, there's just a lot of challenges.

Tanguy Serra (COO):

Yes. Especially with the prediction around an El Nino winter in California.

Brian Lee (Analyst - Goldman Sachs):

Okay. Fair enough. I'm going to try to squeeze one last one in, and then I'll jump back in. And back to cash flow.

Lyndon Rive (CEO):

[It's just rest] to highlight one thing because this is important [to me]. This is not a demand challenge. Q4 bookings is going to be higher than Q3 bookings and that normally does not happen in Q4 because you just have less selling days, so that's normally harder to do that.

Brian Lee (Analyst - Goldman Sachs):

Okay. No. Thanks for that clarification. That's a good point. Going back to cash flow for my last question and then I'll hop off. You're implying that the break-even cash flow is at 3.25 gigawatts of cumulative capacity. Again, based on my math, which I hope is somewhat accurate, it would imply every gigawatt above that gets you to something around $200 million or $250 million of positive EBITDA, assuming you get to your cost targets or even a bit below.

Not asking you to endorse those numbers, but can you give us a sense of not only what break-even is, which you're articulating here for the first time, but a sense of what the EBITDA growth could like as you scale out in the out years, because obviously that's what you're trying to position here for?

Brad Buss (CFO):

As we complete the costs and everything else, we're deep in our planning process right now, we'll consider that. But there's nothing we're looking to give out right now.

Brian Lee (Analyst - Goldman Sachs):

Okay.

Peter Rive (CTO):

I would use, actually, the definition of EBITDA, basically the economic value creation of the business, which was $239 million in this quarter, right? Again, when you use terms like EBITDA, it is [repensued] by free cash flow in the period, but remember, while simultaneously generating hundreds of millions of dollars in economic value.

Brian Lee (Analyst - Goldman Sachs):

Okay. Thanks, guys.

Brad Buss (CFO):

Yes, just take the EVC, replace it with some of the Brian math on the cost. You can do your own modeling.

Brian Lee (Analyst - Goldman Sachs):

I've been trying that, thank you (laughter).

Brad Buss (CFO):

If you need some help, we'll help.

Operator:

The next question comes from Tyler Frank of Robert W. Baird. Please go ahead.

Tyler Frank (Analyst - Robert W. Baird & Company):

Hi guys. Thanks for taking the question. What financing do you need to complete and is the mood to become cash flow positive, is that to avoid future equity raises or should we plan on an equity raise at any point here in the near future?

Brad Buss (CFO):

As far as, to your point on completing, if you look at the financing of the solar systems, it's ABS, and it's aggregation. I went through great pains in the letter, basically showing you that the tax equity is a little different. There's really a tax [op if I devise that].

We've got very strong demand. We've already got the next 7 months covered and I would expect by the end of the year we'll have the balance of the year complete and then the ag facilities are very flexible. We could up them. We move them as we do takeouts in ABS, we'd obviously do much more this coming year.

But we would be able to then recycle that back through. So those facilities are thawing. And then from a working capital perspective, we tend to be using the revolvers and the solar bonds.

Tyler Frank (Analyst - Robert W. Baird & Company):

Got it. And then is there a capacity to potentially do higher megawatt deployment next year or is -- have you guys essentially calculated that this is where we want to be, this level of growth heading into 2017, so that you can better look at the market and judge what you need to do by the prevailing dynamics?

Lyndon Rive (CEO):

Yes, our focus is going to be on cost reduction and cast flow positive. If we have the opportunity to grow more, but still meet those two primary goals, we will, but the primary focus is cost reduction and being cash flow positive. Let me add a comment on that, which is important to understand, which is we don't build our capacity to build ahead of time, because if not we would have idle capacity, so we size our capacity for the build megawatt of that month or that quarter. The way we do that, is we've got the SolarCity University and we're able to onboard and train installers and sales professionals to be able to grow for demand. So the capacity point, if we want to grow more, we will be able to, and deploy that capacity on a real-time basis without incurring (inaudible).

Tyler Frank (Analyst - Robert W. Baird & Company):

Great, and then just one other question.

Brad Buss (CFO):

On the financing, to Lyndon's point, if there's something that's opportunistic or the ITC clarity gets better, whatever, we will have extra financing, just in case anybody is worried about that.

Tyler Frank (Analyst - Robert W. Baird & Company):

Great. Then just one last question, in terms of the manufacturing facility, where do you guys stand today for the construction and what milestones should we be looking out for?

Lyndon Rive (CEO):

We've got the -- we opened our California center in Fremont, where we have 100-megawatt line. We feel very, very good about that. We're excited about what we're seeing coming out of that line. Some of the numbers are ahead of what we thought.

That feels really, really good. So on the technology front, we feel very, very good about where we're at. On the scaling up and manufacturing, the Buffalo facility is on track so far, and we continue to be expecting to be ramping up there in the first half of next year.

Tyler Frank (Analyst - Robert W. Baird & Company):

Okay.

Lyndon Rive (CEO):

Ramping up.

Tanguy Serra (COO):

Yes, yes.

Tyler Frank (Analyst - Robert W. Baird & Company):

Great, thank you.

Lyndon Rive (CEO):

So in other words, we're happy. Things are -- we're very, very happy with the technology there.

Tyler Frank (Analyst - Robert W. Baird & Company):

Great. Thank you.

Operator:

The next question is from Julien Dumoulin Smith of UBS, please go ahead.

Julien Dumoulin Smith (Analyst - UBS):

Hi, good afternoon.

Lyndon Rive (CEO):

Hi.

Julien Dumoulin Smith (Analyst - UBS):

Hey, perhaps could you elaborate a little bit on the regional dynamic playing out here with the execution? Just is it really a northeast thing or just broadly speaking, what drove 3Q and 2016 expectations? I'll leave it there for now.

Lyndon Rive (CEO):

I'm not sure I understand the question.

Julien Dumoulin Smith (Analyst - UBS):

Could you go state-by-state, in terms of the execution on getting the megawatts built out, how is it looking? Is it really weighted one state versus another?

Lyndon Rive (CEO):

No, our east coast states are all doing really well. They're all growing really nicely. California is our number one state.

Brad Buss (CFO):

California is still number one. The east coast is growing quicker, but obviously off a smaller base, so it's a nice number too out in California.

Julien Dumoulin Smith (Analyst - UBS):

Right. Yes, but in terms of the backlog, the time to get these things done, is there any differentiation, is one lagging more than the other in terms of getting them off the ground?

Lyndon Rive (CEO):

Okay. Sorry. The average time to install across the portfolio is about 60 days. It's a little bit less in California, a little bit longer on the east coast, but there's no capacity constraints or anything like that on the east coast. We really, really like the east coast. Maryland is one of the best markets. If you look at, whether it's volume or costs, the east coast markets are really good for us.

Julien Dumoulin Smith (Analyst - UBS):

Got it. And just a little bit cutting back to the 2017 number. I don't want to put words too much in your mouth. But you still got this 1 million customer target, how do you think about the, how back-end weighted is that, to hit that number at this point?

Lyndon Rive (CEO):

Yes, the 1 million customer goal is definitely something that we considered when we were looking at this new focus of absolute cost reduction, and being cash flow positive. I'd say cash reduction and cash flow positive is a higher priority than the 1 million customer goal.

Not giving up on the million customer goal, but that's the first priority. Then we'll see how things go in 2017 and 2018 to what we have to do to accelerate to meet the 1 million customer goal, but the focus is cost reduction and cash flow positive.

Julien Dumoulin Smith (Analyst - UBS):

Right. And then embedded within that, is there an international piece that you're thinking for the 1 million customer, just want to clarify that?

Lyndon Rive (CEO):

No, no, absolutely. The international customer will be counting toward the 1 million customer goal.

Julien Dumoulin Smith (Analyst - UBS):

Great. And any expectations on where that's scaling to, for your 2017 growth, et cetera, just as you think about that mix?

Lyndon Rive (CEO):

Yes.

Tanguy Serra (COO):

I can take that. As you know, we bought in New Mexico. That's trending exactly as per plan. Bill costs in Mexico are significantly lower than they are in the US, just because the part of the reason is the cost of panels, there's no tariff, and so the cost per panel is cheaper.

The bill plans are great. Mexico is doing on track, and we're continue to go evaluate new markets. We have got a couple in the [hopper] that we think are attractive. We're streaming a lot of work up front. Not close to anything, but liking our international plays.

Lyndon Rive (CEO):

One other point I'll make on that is when we look at international markets, for most markets, we're going to create the market. We're going to look at favorable policies, it has to have net metering, it has to have good sun and high cost of energy. But there's no market we can just go in and get gigawatts worth of capacity immediately. We have to build it.

And when you're building residential, you're doubling small numbers at first, and then those numbers become bigger and bigger and start becoming really big. In terms of customer account, it will be adding to the 1 million, but the majority of that will be in the US.

Julien Dumoulin Smith (Analyst - UBS):

Great, excellent, thank you, guys.

Lyndon Rive (CEO):

Thank you, Julien.

Operator:

The next question is from Krish Sankar of Bank of America Merrill Lynch. Please go ahead.

Krish Sankar (Analyst - BofA Merrill Lynch):

Thanks for taking my question. I had a couple of them. First it's very nice to see your focus on cost cuts and the cash flow positiveness. I'm just curious, on the 2016 guidance, would any extension or change in language on the ITC stepdown change your view on the guidance for next year?

Lyndon Rive (CEO):

Just to make it absolutely clear, this focus is assuming that there is no ITC extension. This is why we're focusing. If there is an ITC extension, we'll have re-look at the outcome.

Tanguy Serra (COO):

We'll likely increase volume if--

Brad Buss (CFO):

Yes, big time.

Lyndon Rive (CEO):

And actually, personally, I think it's going to get extended. It's a greater probability that it will get extended, but we have to plan for the fact that it doesn't get extended. And if it does get extended, we're just a much healthier business than any of our competitors to capitalize on that extension.

Brad Buss (CFO):

That's a real key because like Lyndon said, the ability to ramp up sales and operations, it's not like you're bringing up a manufacturing plant that you have idled. They'll be able to bring things up very quickly. I'm not that concerned that we wouldn't be able to scale back up on that.

Krish Sankar (Analyst - BofA Merrill Lynch):

Got it. Got it. All right, and then a follow-up question, do you anticipate earning level at IRRs in projects deployed next year in 2016, or do you expect to continue to raise a higher level of tax equity and securitization relative to your cost? Along the same path, if not, in 2016, what levered returns do you expect once the tax credit steps down?

Brad Buss (CFO):

If you just look at 2016 and assume some lower cost, and then as Lyndon mentioned, pricing being stable to probably trending up a smidge, those are both very beneficial to the influx of that IRR. So they're only going to get better. And 2017, it's a little too early to comment on that.

Lyndon Rive (CEO):

One year at a time.

Krish Sankar (Analyst - BofA Merrill Lynch):

All right. Thanks, guys.

Operator:

The next question is from Stephen Byrd of Morgan Stanley . Please go ahead.

Stephen Byrd (Analyst - Morgan Stanley):

Hi, good afternoon. I wanted to just fast-forward -- I appreciate all your help on this -- to 2017, and just thinking about the competitive playing field in 2017, if the ITC is not extended, just curious your take on what that really does for the smaller competitors and where that puts you relative to your competitors?

Lyndon Rive (CEO):

There's a little bit of background noise coming from your speakers, but the short answer is we currently have the best cost structure in the industry. We're going to have an even better cost structure, and if you don't have really low costs after the ITC expires, you can't be around.

So once the ITC expires, the competitive landscape is going to be completely different, and we're taking action now to make sure that we continue to be the market leader at that point. There's just no way it could work if you don't have a low cost structure in 2017.

Brad Buss (CFO):

A lot of people are going to be extremely challenged to get financed if they don't have the structure to begin with, nevermind the availability of that financing.

Stephen Byrd (Analyst - Morgan Stanley):

Understood. And could that lead to the potential acquisition opportunities or do you think just sticking with organic growth and focusing on your core business is the right way to go, even in that period where there is shake-out?

Lyndon Rive (CEO):

It's actually one of the primary reasons why I think 2017 will be a growth year for us. We're going to have the lowest cost structure and have the best product so customers will come to us.

Tanguy Serra (COO):

[We don't need to make any acquisition.] It's not part of our plan to make any acquisitions with the states.

Lyndon Rive (CEO):

Within the US, yes.

Brad Buss (CFO):

Nobody else has enough scale and the cost and baggage to try to integrate it versus Hayes and Tanguy just scaling up, hiring 100 or 200 people that quite frankly would probably come from those companies anyway. It's much simpler, cheaper, and less risk to do.

Stephen Byrd (Analyst - Morgan Stanley):

Understood. And then just separately on a credit and a number of questions have come up about credit, but you laid out the FICO scores pretty clearly. Any trends in terms of, as your business grows larger, in terms of credit quality, credit strength of customers, default rates, et cetera? Any commentary on that?

Brad Buss (CFO):

No, the trends have been extremely consistent over the eight years, and obviously, we have done more and more business in the last few years. It's an extremely rigorous process as part of the underwriting in the ABS. You can imagine what we must go through there, so I don't see that changing at all.

We would like to broaden the customer reach and that will all just depend on the financing that goes with it. And then as we go international, obviously, that's a different animal, but I don't think we'll change the focus of what we do being the larger roof tops and commercial.

Lyndon Rive (CEO):

Yes, the underlying principle of our deployment is that we charge the customer less than they are currently paying for energy, so default rates, since they lower them, they have the choice of paying us or paying the utility more don't have electricity. Given those three choices, our customers pay the bills.

Stephen Byrd (Analyst - Morgan Stanley):

Very much understood. Thank you very much.

Lyndon Rive (CEO):

Thank you.

Operator:

The next question comes from Gordon Johnson of Axiom Capitol Management. Please go ahead.

Gordon Johnson (Analyst - Axiom Capital Management):

Thanks for taking my question, guys.

Lyndon Rive (CEO):

Sure.

Gordon Johnson (Analyst - Axiom Capital Management):

Next year, just with respect to your backlog, if the ITC does indeed end, assuming it takes roughly four months to put systems on rooftops, could we see a significant fall-off in the backlog ahead of the ITC ending?

Lyndon Rive (CEO):

What we would expect to do is for commercial systems, probably starting as early as Q2, we're going to start pricing in a 10% ITC, so that the customer knows where they're going to be, and depending on the schedule for PTO, for the [utility interconnection], so it could be as early as Q2.

For residential, we'll start seeing that impact probably happen in Q4, but it won't slow down in stores, it's just going to be -- we'll price it correctly, as we will have the cost structure to be able to do that, at that point.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay. That's extremely helpful. Then there's been some recent discussion around some of the lending practices. I'm sure you guys have heard this, with respect to the leasing programs with respect to solar rooftop. Have you guys seen any push back with respect to some of these conclusions around it affecting home values, being more expensive versus outright owning, have you guys seen any pushback from customers or are you not seeing that?

Lyndon Rive (CEO):

No, right now, at the size we are right now, we have probably about 20 to 30 customers move every single day. We haven't seen -- not one has failed in transferring the lease of the PPA, and often there has been an additional value to it, to the house, and the new homeowner likes it. So we haven't seen that.

In terms of cash sales versus leases and PPAs, it's staying roughly flat for us, so our sales, my power is around 10% to 15%. It's been hovering around that number for a few quarters now, so we haven't seen a big movement in the differences between the two.

Gordon Johnson (Analyst - Axiom Capital Management):

Okay. That's helpful. And just lastly, internationally, you guys have talked about expanding internationally, forgive me if you have already been asked this question. I was a little late to the call. Can you give us any updates on expansion internationally and what your plans are there?

Lyndon Rive (CEO):

Yes.

Tanguy Serra (COO):

As you know, we have business Mexico, that continues to do well, as per the plan. Bill costs in Mexico are lower than they are in the US. That feels good, and we're looking at a couple more markets. We're doing a lot of work upfront and figuring out what markets we want to be in.

As Lyndon mentioned earlier, we want to be markets where we can have a residential or commercial platform at least and not just in one vertical, so we're doing a lot of work upfront. There's a couple markets that we like but we're not committed to anything at this stage.

Lyndon Rive (CEO):

I'd characterize our international plans as being depth first, not breadth first. Meaning that we're going to go in the markets, execute well in that market, and when it's humming, move to the next. It's not like we're going to just open a whole bunch of markets speculatively, and burn a whole bunch of cash, and see what sticks. We're going to go into it in a very disciplined way. We're going to pick a market, execute well there, and then move to the next.

Tanguy Serra (COO):

We've launched next year focuses on commercial, next will be residential, and then continue from there.

Brad Buss (CFO):

And again, to put it -- Mexico was a $10 million acquisition, so we're not looking to do anything massive and crazy just to drive scale. We have scale and our focus is going to be on really good returns, good markets, and places we can take our model, which is extremely efficient, and pair it with very good local people that know the markets and work well with us in our culture.

Lyndon Rive (CEO):

But it would be disappointing if we didn't open in another country before the end of next year.

Gordon Johnson (Analyst - Axiom Capital Management):

Excellent. Thanks again for the questions guys.

Lyndon Rive (CEO):

Thank you.

Operator:

The next question comes from Vishal Shah of Deutsche Bank. Please go ahead.

Jerimiah Booream (Analyst - Deutsche Bank):

There is Jerimiah Booream on the line for Vish. I apologize if this has been asked already but I'm just trying to understand the cost levers that you have to pull here. I know you talked a little bit about customer acquisition costs, but what else do you see that could help bring down the costs going into 2017?

Lyndon Rive (CEO):

For the total costs, obviously, we have got a number of things we want to do on the customer [of] acquisition to reduce the costs there. On the ops costs, there's a lot of things we're going to do. First, we're going to roll out a new product, out of Zep , that's going to make our crews more efficient. So that is really good and we'll [continue] that.

We've got panel prices have been roughly flat for the last eight, nine quarters. We think pricing will start declining. That's going to reduce costs. Same thing on inverter prices. Then out of our 80 or so warehouses, by definition, there's a top 50th percentile tile, and a bottom 50th percentile.

The warehouses that are slightly more expensive are because they are either newer or they haven't ramped up, and so when you take the more expensive warehouses to closer to the average, all those things are going to continue to reduce costs. We're going to continue reducing costs on the op side of the house pretty aggressively. And plus what you mentioned earlier is the vertical integration of the commercial.

Tanguy Serra (COO):

And then on commercial, we used to be building costs for projects for well north of $2. On some of our core projects, we're significantly, significantly below that. Brad will maybe give you the number, but we're really, really well below that.

Brad Buss (CFO):

Beautiful. And again, just so we're clear, the absolute operating dollars are going to continue to increase. It's not like we're cutting OpEx dollars from here down. They're going to grow at a much slower rate than the install, so that the cost per watt is dropping. I know there's been some confusion in a few articles I have seen.

I don't want to leave people with the thought that we're doing some massive cost reduction overnight. We're going at this in a very specific manner and using our leverage and our scale to get that cost per watt down. Areas like overhead, a lot of the growth there in systems, and functions and departments began as coming to a near an end.

It will grow much lower than the megawatts, so please keep in that mind as you start looking at your models and start building out your guidance and making sure that you're look at it on a cost per watt, and then back in and into the dollars. That's very important. I don't want to disconnect there.

Jerimiah Booream (Analyst - Deutsche Bank):

Great. That's very helpful. Then just one other question on the international front. As you expand into new markets, and obviously the OpEx associated with that, would you expect to reinvest all cash flows or are you having to think about actual hedges aside from reinvestment in those markets?

Brad Buss (CFO):

The vast majority will get reinvested between the growth and the finance into the business.

Jerimiah Booream (Analyst - Deutsche Bank):

Great, thanks, guys.

Operator:

The next question is from Michael Morosi of Avondale Partners. Please go ahead.

Michael Morosi (Analyst - Avondale Partners):

Hi, guys. Thanks for taking the question. At 350 to 400 megawatt quarter run rate, your sales team in bookings are running pretty solidly ahead of your ability to deploy the systems. Are you at all concerned that some of those sales could churn off the backlog, and is there anything that you can do in the near term to clear what appears to be a building backlog?

Lyndon Rive (CEO):

Yes, so this is the -- one, we are ramping up our installations, so that will catch up to them. This is the part I mentioned earlier, is we're going to focus now on the lower acquisition costs. We're going to focus on the profitable customers and so you'll see the bookings and installs getting closer to one another, but there will still be a delta because at a 40% growth rate, you still have to have a delta, but you'll see those two lines getting closer to one another.

Michael Morosi (Analyst - Avondale Partners):

Okay. And then to the extent that you're beginning to optimize the overall Organization and the cost structure, for a post-30% ITC world, have you thought at all about what a sustainable run rate looks like in 2017 and beyond? Is it close to 2016 or do you think there's room for material growth to the Organization beyond that.

Lyndon Rive (CEO):

Just make sure I understand the question. Do I think the growth rate would be higher than 40% in 2017.

Michael Morosi (Analyst - Avondale Partners):

No, just the ability to deliver growth from that level. What do you think is a sustainable level of annual installs?

Lyndon Rive (CEO):

Yes, it's a little early to give you the actual percentage of growth, but I'm highly confident that it will be a growth year over 2016.

Michael Morosi (Analyst - Avondale Partners):

Okay. And then just finally, as it relates to Silevo, how are you thinking about the potential impact to cost per watt, looking out into 2017? It doesn't seem like it's going to factor in too much in 2016, but is that going to be another lever to pull in terms of reducing overall costs there, and by what factor?

Tanguy Serra (COO):

Yes, absolutely. As Lyndon said, we'll wait until next quarter to give better guidance on costs, but at high level, if you have 250-watt panel versus a 350-watt panel, you just need way less panels on a given house or a given rooftop, and as a consequence, your labor costs go down proportionately, your hardware costs go down proportionately, your wiring costs go down proportionately, so the ripple effect of a higher efficiency panel through the system is massive.

Lyndon Rive (CEO):

The number that I have been using is relative to today's costs, it's about a $0.25 a watt advantage.

Michael Morosi (Analyst - Avondale Partners):

That's helpful. Thanks guys.

Operator:

The next question comes from Edwin Mok of Needham & Company. Please go ahead.

Edwin Mok (Analyst - Needham & Company):

Hey, guys. Thanks for squeezing me in and I caught in a little late if there was touched already about this, but [this level] -- have you guys talked about how long you think it will take for you to ramp up to 1 gigawatt full capacity? And also the market is [able to] sustain a much higher price with this high efficiency module, have you guys thought about selling [module rod] and using them (inaudible) in installation?

Tanguy Serra (COO):

So we're hoping for early 2017 to be fully ramped at 1 gigawatt capacity in Buffalo. Yes, there's going to be a lot of incredibly differentiating things, a lot of differentiating things about SolarCity's products and services when we have Silevo. So that will further our competitive edge when we have what I believe to be the best module on the planet.

Lyndon Rive (CEO):

Yes, but keep that margin within to the -- get the benefit with our installation to keep the high efficiency for ourselves. The gigawatt facility won't even be able to supply our own needs.

Edwin Mok (Analyst - Needham & Company):

I see. Focus is small for internal consumption. Okay. That's helpful. And then on the securitization front, it sounds like you guys are building up the MyPower loans. Any way you can help us think about, in terms of your view of the market, how much you need or how many loan contracts you need before you can really access the securitization market using those products, or is there a way to think about it, maybe give a range of number of contract you need or something like that?

Brad Buss (CFO):

Like I said before, it's really a function of having a complete tax equity fund to put in there. You really can't split it in chunks, so as the funds get down, like I said, they'll go in. If you look at it from the end ABS market, and it was a great thing, when we did that last ABS, it was in the beginning of the solar turmoil. I did it postmortem, post meeting with some of our lenders in the banks, and the biggest complaint they had is we want bigger ones and we want it more frequent.

Those are great problems to have. The nice thing is, with the backlog of the financing receivable that we have, that's exactly what we'll be delivering going forward. So we're in a good position, though they'll probably tend to get bigger than what we've historically done, because our funds are technically getting bigger, so they will be bigger, and again, like I said, more frequent.

Edwin Mok (Analyst - Needham & Company):

Have you thought about being the underwriter on it and just securitize [only your] products, actually securitize other people's products, as well, given your success in the securitization versus the rest of the industry?

Brad Buss (CFO):

We've got our hands full with our own stuff. If you look at it, we've got a very good team that spends the time on the structuring so that we could structure these things, get them to market quicker, and manage the fees and the credit enhancements that tend to go with that. So we're going to stay very focused there for quite a while.

Lyndon Rive (CEO):

And one of the benefits of vertical integration is you have everything -- all the interaction with the customer, you have all the information about the customer, you have all your cost structures, everything is available. You have all the production. This is the reason we're the first Company to really succeed at securitization, so taking on that for some of other assets would be a big undertaking, and we just have this streamlined system within our Company.

Brad Buss (CFO):

And remember, it starts with that tax equity fund, right, That's the root of all evil because that deals with the [IA] all the way through to the ABS. We have to have a team that works in concert in this financing factory to make sure all of these fit smoothly, and to try to pick up someone else's wacky structure or fund or something and do it is really hard.

That's why you're not seeing other people being able to do the ABSs like we have, or be successful at them, because it's a dog's breakfast, maybe between the assets and/or the structures that makes it very hard to securitize. So we'll continue to lead pack and pave the way.

Edwin Mok (Analyst - Needham & Company):

Yes, I agree that is differentiation for you guys. Last question I have on commercial, maybe you guys touched on it already, but off the new guidance 1.25 gigawatt, have you talked about how much of that will be commercial?

Brad Buss (CFO):

We have Not. Next question please.

Edwin Mok (Analyst - Needham & Company):

The question is can you tell us roughly what level of that would be commercial versus residential?

Tanguy Serra (COO):

It's reasonable to expect that it's about the same mix as what we have done in Q3, give or take.

Edwin Mok (Analyst - Needham & Company):

I see. Okay. Similar to what we have. Okay, great. That's all I have, thank you.

Operator:

The next question comes from Pavel Molchanov of Raymond James. Please go ahead.

Pavel Molchanov (Analyst - Raymond James):

Hey, guys. Since I'm towards the end of the call, I'll ask a high level one, if I may. A year ago, the stock was trading at 3 times retained value. Today it's trading at 1 times retained value. What do you think went wrong?

Brad Buss (CFO):

You mean net retained value? Net retained value?

Pavel Molchanov (Analyst - Raymond James):

Net retained value, indeed. What's the market not getting?

Lyndon Rive (CEO):

If I figure that out -- we create, and it's just not even the net retained value, look at our economic value that we created the EVC slide. The Company this last quarter generated $239 million of value. It's very close to generating -- it's very close to a $1 billion run rate.

For it to be where it is right now, I don't know. So this is why we're focusing on cost. Maybe the market doesn't think that we have a cost structure that can work in 2017. This is why we focus on this. We'll prove it out in 2016. Hopefully that helps.

Pavel Molchanov (Analyst - Raymond James):

Okay. Given the pivot to a more refocused installation model, does it still make sense for you to be in 19 states, because that number has been pretty consistently increasing almost every quarter?

Lyndon Rive (CEO):

Yes, we will optimize our cost structure to make sure that every [location] is adding cash to the business, so yes, we'll absolutely look at that. We most likely wouldn't be expanding to many more states right now, but we'll look at the existing states to see are they adding cash to the business, and for the most part, they all are.

Pavel Molchanov (Analyst - Raymond James):

Okay. That's good to hear. Appreciate it.

Operator:

There are no further questions at this time. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

Brad Buss (CFO):

Thank you.

Lyndon Rive (CEO):

Thank you, everybody.